IRS Affirms Rule on Reimbursements and Wages

by James F. McDonough, Jr. on December 5, 2012

The rules governing employee wages, reimbursements and taxes have been confusing for some business owners who have been levied taxes for improper accounting. However, the Internal Revenue Service provided more clarity on the issue in a recent ruling.

The ruling reaffirms the existing tax law governing reimbursements, which states that expenses incurred by employees must have a business connection in order for workers to be reimbursed tax-free. The agency outlined several scenarios in which companies have improperly recharacterized employee taxable wages as nontaxable business expense reimbursements.

In one example, technicians' wages were reduced, but workers received the difference in nontaxable tool allowances. The company then only restored their taxable income when technicians had maxed out their tool allowances. The IRS disputed this business connection, ruling that workers always received the same gross amount regardless of whether they used their tools. The same logic was also assigned to a case involving nurses, some of whom saw their wages reduced when traveling overnight, but received the amount as a per diem to cover costs. The IRS reaffirmed that they were receiving the same gross pay, regardless of whether they incurred expenses.

The last scenario involved construction workers who were reimbursed mileage for using their personal vehicles to visit different job sites. However, the IRS took issue with this scenario, arguing that employees who didn't incur expenses traveling still received reimbursements on a frequent basis.

In order to be classified as a nontaxable business reimbursement under IRS scrutiny, employees must have incurred legitimate company expenses and been reimbursed the amounts in addition to their wages, rather than in place of their earnings.